Euler Hermes Economic Research

Country Risk Analysis

# Bahrain

## Outlook dependent on domestic stability

### General Information

| | |
|---|---|
| **GDP** | USD22.9bn (World ranking 101, World Bank 2011) |
| **Population** | 1.32 million (World ranking 154, World Bank 2011) |
| **Form of state** | Constitutional Monarchy |
| **Head of government** | KHALIFA bin Salman Al-Khalifa |
| **Next elections** | 2014, legislative (Council of Representatives) |

### Strengths

- Relatively (in regional context) diversified economy, with oil, manufacturing (including aluminium and petro-chemicals) and financial sectors.
- Pro-business stance and commercial and trading environment rated highly by independent international assessments.
- Financial and other support from larger regional states, particularly Saudi Arabia.
- High incomes.

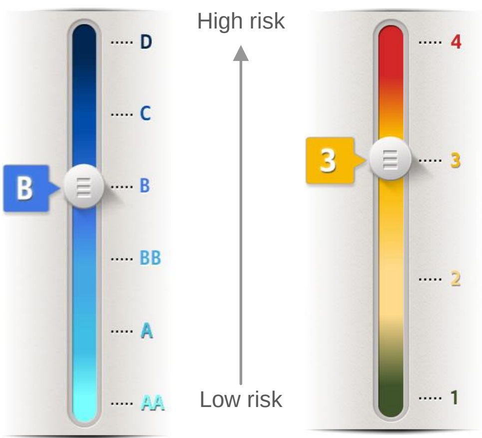
### Weaknesses

- Tensions between ruling Sunni elite and the Shia majority came to the fore with the Arab Spring and these have not been addressed effectively.
- Regional volatility, including potential for adverse contagion stemming from events in neighbouring Iran and Iraq.
- Despite economic diversification, there is still a dependence on oil revenues, directly (own output) and indirectly (regional influence).
- Poor data transparency.

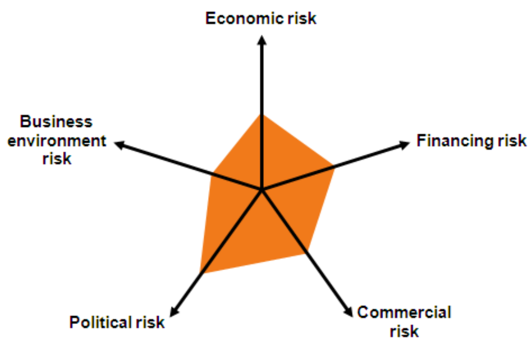
### Country Rating

B3

**Country Grade** **Country Risk Level**

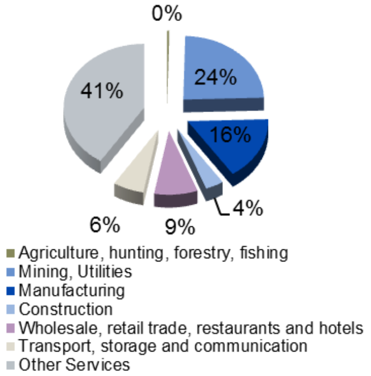



### Risk Dimensions



## Economic Structure

### GDP breakdown (% of total, 2010)




### Trade structure (% of total, 2010)

By destination/origin

| Exports | | Rank | | Imports |
|---|---|---|---|---|
| Saudi Arabia | 12% | 1 | 34% | Saudi Arabia |
| United Arab Emirates | 7% | 2 | 9% | United States |
| India | 6% | 3 | 7% | China |
| Japan | 6% | 4 | 5% | Brazil |
| Qatar | 6% | 5 | 5% | Germany |

By product

| Exports | | Rank | | Imports |
|---|---|---|---|---|
| Petroleum, petroleum products and related materials | 31% | 1 | 8% | Road vehicles |
| Non-ferrous metals | 22% | 2 | 7% | Metalliferous ores and metal scrap |
| Metalliferous ores and metal scrap | 16% | 3 | 6% | Non metallic mineral manufactures, n.e.s. |

Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

## Economic Forecast

| | Average 2000-08 | 2009 | 2010 | 2011 | 2012 | 2013f | 2014f |
|---|---|---|---|---|---|---|---|
| GDP growth (% change) | 6.3 | 2.5 | 4.3 | 1.9 | 3.4 | 3.5 | 3.5 |
| Inflation (%, end-year) | 1.9 | 1.6 | 1.0 | 0.2 | 2.6 | 3 | 2.8 |
| | | | | | | | |
| Fiscal balance (% of GDP) | 2.0 | -6.6 | -7.0 | -1.7 | -2.2 | -1.7 | -4.0 |
| Public debt (% of GDP) | 27.6 | 25.4 | 35.5 | 36.5 | 37.3 | 37.8 | 39.3 |
| | | | | | | | |
| Current account (% of GDP) | 7.1 | 2.4 | 3.0 | 11.1 | 12.3 | 9.2 | 6.1 |
| External debt (% of GDP) | 47.9 | 56.2 | 53.4 | 50.4 | 49.5 | 48.2 | 46.8 |

Sources: IHS Global Insight, National sources, Euler Hermes

## Economic Growth

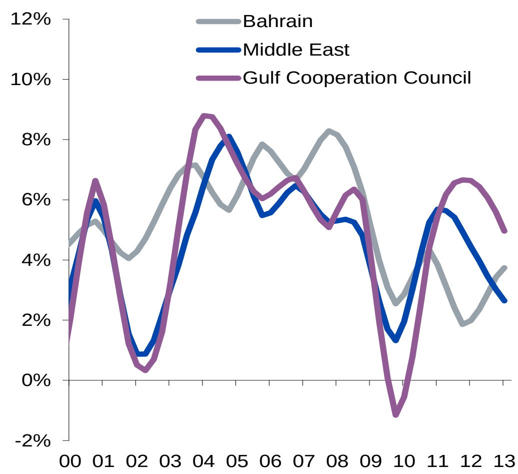
### Growth recovered in 2012

GDP growth (+3.4%) improved in 2012, following the downturn in 2011 (+1.9%) resulting from domestic political unrest and weak external markets in the eurozone. In 2012, the recovery was a result of a rebound in non-oil output (manufacturing, hotels and restaurants, insurance and, to a lesser extent, construction and banking) because crude oil production contracted because of disruption in the Abu Saa'fa field.

### Growth outlook in 2013-14

EH expects GDP growth of around +3.5% in both 2013 and 2014. Higher rates of growth depend on rebuilding consumer and investor confidence and these depend on maintaining security and improving domestic stability. Moreover, growth rates depend on performance by the oil, mining and financial sectors and this will also reflect uncertain global developments. Accordingly, the GDP forecasts have upside and downside risks that cannot be accurately foreseen.

### GDP growth (y/y, 4 qtrs cumulated %)

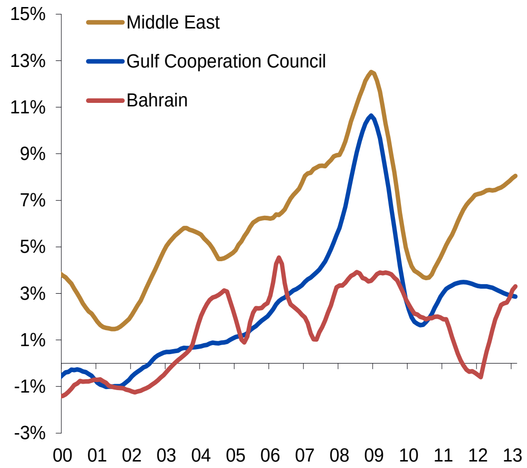



Sources: IHS Global Insight, Euler Hermes

## Economic Policies

As elsewhere in the GCC, particularly Oman and Saudi Arabia, Bahrain is increasingly adopting a policy of providing nationals with jobs rather than foreign workers (Bahrainisation). Implementation of the policy became more imperative with the Arab Spring and associated unrest that partly reflected poor job prospects. Currently, more than 70% of the workforce consists of expatriates and domestic unemployment and poverty is particularly high among the majority Shia population. However, the capital intensive nature of industry does not provide a significant number of additional jobs.

**Inflation rate (%)**



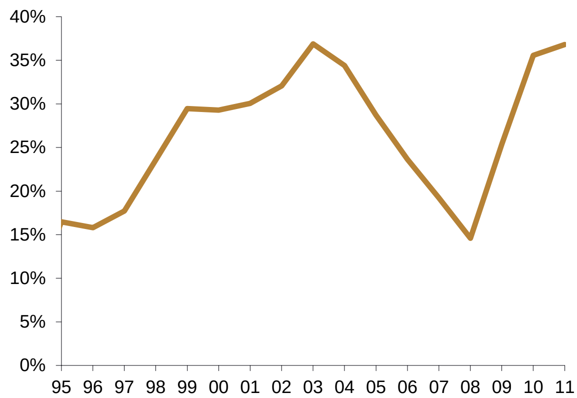

Sources: IHS Global Insight, Euler Hermes

### Inflationary pressures from low base

Inflationary pressures were relatively subdued until 2012, with an annual average end-year inflation rate of around 1.7% in 2000-11. Since then, increased social spending by the state has boosted demand and growth in prices. The latter has also been fed by relatively large increases in housing and utility prices, reflecting changes to state subsidies. Global commodity prices have eased somewhat and inflationary pressures through food prices will be muted in 2013. Overall, annual inflation will remain above the long-term average but is unlikely to exceed 3% in 2013 and 2014.

EH does not envisage that the exchange rate regime will be changed in the review period to end-2014. Expect the fixed peg of BHD0.376 = USD1 throughout that period. Bahrain is unlikely to take unilateral action on its exchange rate, preferring to await the onset (timing indeterminate) of the Gulf monetary union and single currency. EH does not expect the introduction of an effective common GCC currency before end-2014.

**General government gross debt (% of GDP)**




Sources: IHS Global Insight, Euler Hermes

### Fiscal deficits

Official budget projections tend to overestimate deficits through adoption of conservative oil prices in the forecasts. Accordingly, while state spending will remain high in attempts to assuage social dissent, the 2013 deficit outcome will remain manageable at around -1.7% of GDP (-2.2% in 2012). However, continued high state expenditure and likely easing in international oil prices, will increase the deficit in 2014 (-4%), although Bahrain's finances will continue to be underpinned by financial aid from fellow-members of the GCC, particularly Saudi Arabia. The GCC has pledged around USD10 billion in direct budgetary aid over the next ten years.

Public debt has increased rapidly since 2008 and currently amounts to around 37% of GDP. Most of the increase derives from external debt issuances. In July 2012, Bahrain auctioned ten-year paper raising USD1.5 billion. The IMF recently warned of the dangers inherent in boosting public debt.

# External Sector

## Strong current account surpluses

Despite the political and social turmoil in 2011, the current account of the balance of payments registered a surplus of 11.1% of GDP (3% in 2010). High global oil prices boosted exports of refined products but there was also a positive growth registered by non-oil exports (mainly aluminium, rebar and petrochemicals). By contrast, the protests and demonstrations weakened growth in import demand. The same trends continued into 2012 (surplus 12.3% of GDP), with an additional boost from a recovery in tourism revenues (mainly from people driving over the King Fahd Causeway from Saudi Arabia). EH expects export receipts will weaken as global energy prices ease in 2013-14 and double-digit current account surpluses will not continue. Nevertheless, annual surpluses will remain in excess of 6% of GDP.

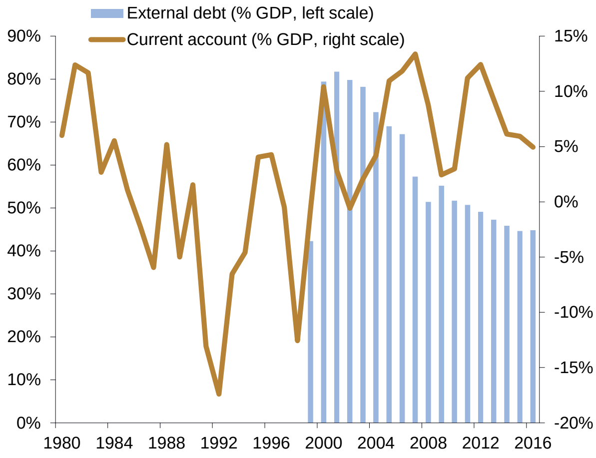
## External debt ratios remain comfortable

External debt ratios are comfortable with debt/GDP and debt/export earnings forecast at around 48% and 57%, respectively, in 2013. Annual servicing commitments on external debt are quite low and forecast to remain <4% of export earnings in 2013 and 2014.

## Moderate import cover but financial support

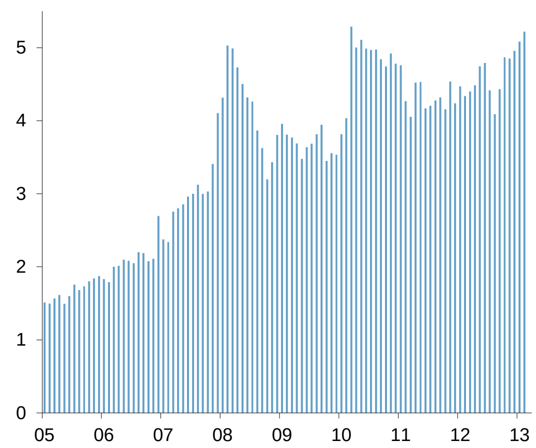
Foreign exchange reserves of around USD5 billion provide import cover of just below four months, compared with an international benchmark comfort level of three months. In addition, Bahrain has an oil stabilisation fund for use in times of economic hardship and Saudi Arabia remains ready to supply further support, in need. All this tends to signify that problems should not arise in relation to trade payments and other financial obligations.

**External debt (% of GDP)**




Sources: IHS Global Insight, Euler Hermes

**FX reserves (USDbn)**




Sources: IHS Global Insight, Euler Hermes



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